Personal Care Workers. The Administration's proposal would also directly increase employment in one low-wage area--personal care and other in-home workers. Although most aspects of it aim to reduce spending on health care, the proposal would substantially increase funds for home- and community-based care, which would expand the employment of both higher-paid and lower-paid workers in this sector.

The proposal also could bring into the labor force statistics--and into the gross domestic product accounts--an unknown number of family members who currently provide uncompensated care for the disabled. Current rules do not permit these people to be paid with government money, and thus they are not counted in the labor force or in GDP. The proposal would allow these people to be paid and thus bring them into both sets of statistics. The recognition of the work effort of these family members would be important to the disabled and their families. From the national point of view, however, this would be largely a statistical change and would not alter the true amount of economic activity.

What Would Happen to the Structure of the Labor Market?

The Administration's health proposal would create incentives for reorganizing the structure of production. To start, these incentives would alter the number of hours that people work, and particularly the decisions of firms to hire full-time or part-time workers. The proposal would also allow workers to switch jobs without losing insurance, but it might induce some reallocation of workers among firms in an effort to receive greater government subsidies.

Hours of Work

The Administration's proposal would affect not only the number of workers in the economy but also the number of hours that they work. Specifically, the proposal would encourage a reduction in hours for full-time workers in subsidized firms but an increase in hours for full-time workers at some unsubsidized firms. The proposal would also encourage a reduction in the hours of most part-time workers.

Subsidized Firms. Under the proposal, subsidized firms would pay an implicit levy on the wages earned by their employees from each additional hour of work. At many subsidized firms, this levy would equal 7.9 percent; at small firms with low average wages, it could be as low as 3.5 percent. The levy would apply to full-time and part-time workers in the same way, and would be passed back to workers in the form of lower wages. This provision would create an incentive for both full-time and part-time workers at subsidized firms to reduce their hours of work.

Unsubsidized Firms. At unsubsidized firms, the proposal would impose no added cost on the wages earned from additional hours of work by people already working more than 30 hours per week. Thus, at unsubsidized firms that offer insurance today, the proposal would have no appreciable effect on hours worked by full-time employees. At unsubsidized firms that do not offer insurance today, however, there would be a new fixed cost of hiring additional full-time workers, which would cause firms to use more overtime by their existing workers.

Part-time employees at unsubsidized firms would face an implicit levy on hours because the proposal prorates premiums for these workers. For an additional hour of work by employees working between 10 and 30 hours per week, unsubsidized firms would generally have to pay one-thirtieth of the basic employer premium. This amount could be large relative to the wages of some low-wage workers.[22]

Workers with Very Short Hours. The proposal might cause some firms to increase their use of employees who work fewer than 40 hours per month

22. The proposal would impose particularly large costs on part-time workers with jobs in more than one unsubsidized firm. For example, the combined employer premiums for a worker who has two 20-hour-a-week jobs are 33 percent more than the employer premium for a 40-hour worker with just one job. This situation does not exist for workers in subsidized firms because they pay a fixed percentage of their salary regardless of their hours of work.

because neither subsidized nor unsubsidized firms would be required to pay premiums for these workers. The number of such workers would probably be small, however, and they would primarily be workers with low training and transportation costs.

Effect on "Job Lock"

Some of the proposal's provisions would reduce problems created by the current employment-based system of health insurance. Under the current system, people may be reluctant to leave the safety of a large corporation to work in a small company or start a small business because they fear losing their health insurance. Because the proposal would establish universal coverage and prohibit restrictions based on preexisting health conditions, this fear would be lifted. Workers could choose jobs that gave them the most satisfaction and at which they had the highest productivity, thus improving economic efficiency.

The quantitative importance of job lock is unclear, however. Public opinion surveys suggest that 10 percent to 30 percent of people feel locked into their current jobs because of their fear of losing health insurance.[23] But statistical studies of the extent to which this fear actually reduces job mobility have reached mixed conclusions.[24] Overall, the weight of evidence suggests that job lock probably hinders the operation of the labor market to some degree, but the magnitude of the effect cannot be reliably estimated.

Reallocation of Workers Among Firms

The current system of employment-based health insurance influences the allocation of workers among firms. People who receive insurance coverage through their spouses--or low-wage workers who place a low value on health insurance relative to their other needs--have an incentive to work at firms that do not offer health insurance but pay higher wages instead. At the same time, higher-wage workers who do not have alternative access to insurance typically work at firms that provide insurance coverage.

The Administration's proposal would eliminate the allocation of labor based on workers' demand for insurance. But the proposal would substitute an incentive for reallocating labor (so-called "sorting") based on wages: to take advantage of the subsidies to firms available under the proposal, low-wage workers would migrate to firms with low average wages, and high-wage workers would eventually move to firms with high average wages. As with many other issues discussed in this chapter, the precise effects of the proposal would vary among workers and firms (see Box 4-2).

This sorting would occur because the subsidies are based on the characteristics of firms; subsidies based purely on individual or family characteristics would not have this effect, nor would a payroll tax levied at uniform rates on all firms. Therefore, these incentives for sorting are somewhat particular to the financing mechanism in the Administration's proposal. Of course, alternative schemes for financing universal coverage could also introduce new distortions, though the precise effects would depend on the details of any alternative.[25]

The Incentive for Sorting. A simple example illustrates how workers could benefit by moving between firms that were subsidized and firms that were unsubsidized. If an unsubsidized firm hired an additional single, childless worker at an annual salary of $10,000, its payments to the regional alliance

23. Erik Eckholm, "Health Benefits Found to Deter Switches in Jobs," *The New York Times*, September 26, 1991, p. 1; Christopher Conte, "Labor Letter," *The Wall Street Journal*, June 15, 1993, p. A1.

24. Douglas Holtz-Eakin, "Job-Lock: An Impediment to Labor Mobility?" *Jerome Levy Economics Institute of Bard College Public Policy Brief*, vol. 10 (1993); Brigitte Madrian, "Employment-Based Health Insurance and Job Mobility: Is There Evidence of Job-Lock?" Working Paper 4476 (National Bureau of Economic Research, Cambridge, Mass., September 1993); Jonathan Gruber and Brigitte Madrian, "Limited Insurance Portability and Job Mobility: The Effects of Public Policy on Job-Lock," Working Paper 4479 (National Bureau of Economic Research, Cambridge, Mass., September 1993).

25. Louise Sheiner, "Mandates with Subsidies: Efficiency and Distributional Consequences" (Federal Reserve Board, January 1994).

would rise by $2,031 (CBO's estimate of the employer share of the premium in 1998). By contrast, a subsidized firm would have to pay only $790 to the alliance if it hired the worker, since subsidized firms would pay only 7.9 percent of payroll for insurance. If the worker had the same value to both firms, the subsidized firm could pay a substantially higher annual salary--as much as $1,241 more--than the unsubsidized firm. This is a rather large difference; it would increase the worker's salary by more than 12 percent.

The incentive would work in the opposite direction for higher-wage workers, though it might take a long time to affect where people work. A single, childless worker earning an annual salary of $40,000 would have to give up $3,160 of his or her salary for insurance in the subsidized firm (7.9 percent of $40,000), and thus could save up to $1,129 each year by moving to an unsubsidized firm, where the premium would not be based on salary.

The size of the sorting incentive would vary among both workers and firms. In the example above, the incentive would obviously be amplified for workers with annual salaries above $40,000 or below $10,000. In addition, small firms with very low average wages would have capped rates as low as 3.5 percent, which would further boost the incentive for low-wage workers to work at these firms. Last, the size of the incentive would depend on the family status of the worker--workers with children would face higher premiums at unsubsidized firms than workers without children. At subsidized firms, the employer share of the premiums would simply be 7.9 percent of the worker's wages or salary whether the worker was a single adult, or part of a couple or a family with children.

Forms of Sorting. Sorting could take several forms, some involving actions of workers, some involving actions of firms, and some involving actions of both parties. For example, new workers in the labor force could choose jobs with certain firms rather than others. Or existing workers could quit and move to different firms.

Firms could "outsource"--that is, lay off employees and contract with other companies for the

Box 4-2.
Sorting of Workers in the Administration's Proposal

The incentive for sorting under the Administration's proposal would vary among workers, but most workers can be classified into one of three groups for this purpose.

First, the Administration's proposal would provide a substantial new incentive for sorting among workers who place a significant value on insurance and whose wages are flexible in the long run. Because these workers' wages adjust to reflect the cost of their employment-based health insurance, these workers face no incentive under the current system to leave their jobs. But under the proposed system, those who have low wages would seek jobs at subsidized firms, while those with high wages would seek out unsubsidized firms. This group is rather large--it includes all heads of households except those with very low incomes.

The second group of workers are those who place a high value on insurance but whose wages are not flexible even in the long run. Because the productivity of these workers may not be high enough to cover the minimum wage plus the cost of health insurance, they tend to find work at firms that do not offer insurance. If the current system is maintained, more of these workers would be forced into uninsured firms as the cost of health insurance rose. By contrast, the subsidies in the Administration's proposal would reduce this incentive for sorting. This group is not large and consists primarily of minimum-wage and near-minimum-wage workers.

The last group consists of workers who place a low value on insurance. The current system encourages these workers to work at firms without insurance, and again this incentive increases as health insurance costs rise. The Administration's proposal would eliminate this incentive for sorting because every firm would have to offer insurance. But the proposal would substitute an incentive for high-wage workers in this group to move to firms with high average wages and low-wage workers to move to firms with low average wages. This group is fairly sizable because it includes most secondary workers and some younger and poorer primary workers as well.

same services. For example, a firm with high average wages, which would be unsubsidized under the proposal, could give up its company's cleaning help and hire an outside cleaning service instead. Alternatively, firms could divide themselves into subsidiaries with low and high average wages. For example, a manufacturing plant could spin off its research and development lab.

Although the proposal contains legal restrictions on some of this sorting, they would not be totally successful.[26] The proposal would increase the Internal Revenue Service's authority over the classification of employees and independent contractors, but reclassification of these workers is just one of several ways in which firms could respond to the proposal. Moreover, any simple regulation is unlikely to prevent the creation of new firms that could use the subsidies to their competitive advantage against existing, regulated firms.

Sorting Would Raise the Cost of Federal Subsidies to Firms. When sorting occurs, workers would be reallocated among firms in a way that reduced the private cost of their health insurance. But this reduction in private cost would be exactly offset by an increase in government spending.

Of course, it is difficult to determine exactly how much sorting would occur under the Administration's proposal. Some restructuring along salary lines may be occurring anyway.[27] There are no empirical estimates indicating the sensitivity of the allocation of workers to incentives of this type. But the incentive for sorting under the proposal would be fairly large for many people. CBO estimates that in 1998 almost 8 million low-wage workers could receive salary increases of 10 percent or more by moving from unsubsidized to subsidized firms. And the average increase in salary for workers earning less than $20,000 who migrated from unsubsidized to subsidized firms would be over 15 percent.

CBO assumes that 20 percent of the workers would eventually respond to a potential 10 percent increase in their after-tax salaries; workers facing larger or smaller incentives would have proportionally larger or smaller responses. This sorting would not occur immediately, however. CBO assumes that it would take 10 years after full implementation of the proposal for sorting to reach its full extent and estimates that sorting could increase the cost of subsidies to firms by some $12 billion (or 14 percent) in 2004, an amount incorporated in the cost estimate in Chapter 2.

Sorting Would Alter the Effects of the Proposal on Employment. As discussed in an earlier section, the requirement that firms pay for health insurance would reduce the employment of low-wage workers. The sorting of these workers among firms would mute this effect, however. Low-wage workers who are currently uninsured would be induced to leave unsubsidized firms where they would face large implicit increases in the minimum wage and move to subsidized firms where the implicit minimum wage increase would be relatively modest. This migration would limit the number of displaced workers.

At the same time, sorting could produce some temporary loss of employment, if workers lost their jobs and were forced to look for new ones. Ironically, the harder the government tried to prevent sorting in the form of simple legal reorganizations, the more it would encourage firms to sort workers by laying them off. Of course, employers would be trying to contract with other companies to provide the same services, so overall demand in the economy for these workers' skills might be unaffected. But this possibility does not mean that the same workers would find jobs immediately, and those that could not would experience some short-run unemployment.

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26. Eugene Steuerle, "The Proposed Segregation of the Labor Market by Economic Class," *Tax Notes*, vol. 61, no. 5 (November 1, 1993), pp. 621-622.

27. Because some sorting would occur without any policy change, the subsidies to firms would grow over time even if the Administration's proposal induces no additional sorting. In other words, what matters for the cost of subsidies is the total amount of income-based sorting, not just the amount created by the proposal. See Katharine G. Abraham, "Restructuring the Employment Relationship: The Growth of Market-Mediated Work Arrangements," in Katharine G. Abraham and Robert B. McKersie, eds., *New Developments in the Labor Market* (Cambridge, Mass.: MIT Press, 1990); Katharine G. Abraham and Susan K. Taylor, "Firms' Use of Outside Contractors: Theory and Evidence," Working Paper 4468 (National Bureau of Economic Research, Cambridge, Mass., September 1993); and Steve J. Davis and John Haltiwanger, "Wage Dispersion Between and Within U.S. Manufacturing Plants, 1963-1986," Working Paper 3722 (National Bureau of Economic Research, Cambridge, Mass., March 1991).

Sorting Could Reduce the Efficiency of the Labor Market. A competitive market economy allocates workers to jobs where their productivity is highest. The current health insurance system distorts that allocation in at least two ways. First, it provides an incentive for workers who place a low value on health insurance received through their jobs to work for firms that do not offer insurance. Second, it raises the cost of labor at firms for which health insurance is more expensive. These distortions lower the efficiency of the labor market and the economy.

The Administration's proposal would eliminate these distortions, but would create a distortion of a different type, in which workers at different wage levels would have an incentive to work for different firms. By contrast, the current system creates no incentive to separate high- and low-skill workers into different firms. And most firms currently include both low-wage and high-wage employees, suggesting that heterogeneous wage (and skill) structures at firms may be more efficient than the homogeneous structures encouraged by the proposal. This efficiency may depend partly on the nature of production processes, which often involve people of different types and levels of skill. It may also depend on the difficulty of conducting transactions through explicit contracts with independent firms rather than informal arrangements within a single firm.

If grouping workers among firms by income or skill level is very inefficient, then the allocation of workers encouraged by the proposal might be less efficient than the current allocation. Also, the process of sorting--of reallocating workers--would entail administrative and organizational costs that would reduce efficiency. But if the efficiency cost of sorting were high, then the speed and ultimate amount of sorting would be relatively low.

What Would Happen to the International Competitive Position of the United States?

When the government makes policy changes as far reaching as the Administration now proposes, one of the biggest concerns of many businesses is how the changes might affect their international competitiveness. CBO's analysis concludes that because the proposal would affect different firms in different ways, some firms would become more competitive and some firms less so. But no solid conclusions can be drawn about whether the overall trade balance would increase or decrease.

Overall Competitiveness: The Balance of Trade

The notion of the "international competitiveness" of the whole economy is hard to define, but what most people mean by it, in practical terms, is a concern that the United States may lose exports or absorb more imports. Working by analogy with an individual firm, it is commonly believed that anything that increases costs would make the balance of trade worse, and anything that decreases costs would improve it. Almost all economists disagree with this view, however, because it neglects some important connections that exist in an entire economy but do not apply to an individual firm.

At a fundamental level, the trade balance of any country is constrained because a country, unlike a firm, can sell abroad only that part of its production that it does not consume or invest itself. Hence, the net amount of sales abroad--the balance of trade--depends most directly, not on costs of production, but on saving and investment.[28] The trade balance improves only if national saving rises, investment falls, or both.

The Administration's health proposal would have indeterminate effects on both national saving and investment. Thus, it is difficult to predict how the proposal would affect the balance of trade.

National Saving. According to CBO's estimates in Chapter 2, the Administration's proposal would marginally raise the federal budget deficit for most of the next decade, though ultimately it would decrease it. A decrease in the federal deficit corresponds to an increase in national saving.

28. Congressional Budget Office, *Policies for Reducing the Current-Account Deficit* (August 1989).

The proposal could also affect private saving through several channels. First, universal health insurance would reduce some of the need of individuals to save for precautionary reasons. Precautionary saving arises when individuals are uncertain about, for example, their future income prospects, their life span, or the amount of money they may need to spend on medical services. In the case of medical needs, the amount of precautionary saving would depend on the probability of incurring outlays, the amount of outlays likely to be incurred, and the cost of insurance. It would also depend on income, wealth, and attitudes toward uncertainty. Because the proposal would eliminate the risk of losing insurance and facing large, unexpected medical expenses, it would probably reduce precautionary saving.[29] Of course, the reduction in risk would itself improve people's well-being. Second, some people between the ages of 55 and 64 might save less if the proposal encouraged them to retire earlier. This group, if they continued working, would normally have relatively high saving rates.

At the same time, two factors would work to increase private saving. First, some workers might want to save more during their working years if the proposal encouraged them to retire early. Second, the plan might reduce some people's incentive to spend down their assets if they expected to need Medicaid when they were older. The proposal would allow states to raise the maximum level of assets that single people on Medicaid could keep, thus slightly increasing the incentive to save. Overall, the proposal might reduce national saving somewhat.

Investment. It is even more difficult to predict the effect of the proposal on investment. Because reallocating the burden of health care costs would affect industries very differently, some would increase investment and some decrease it. On net, because it is hard to shift plant and equipment from one firm or industry to another as one contracts and the other expands, such shifts could increase national spending on investment while adjustments occurred. But the effect would be very small: industries are always growing and declining, and the additional shifts as a result of reallocation of health care costs would be difficult to discern. Other factors--especially changes in the health care industry itself--could also affect investment, but it is impossible to predict whether they would cause investment to go up or down. On balance, the effect of the Administration's proposal on investment is uncertain.

The Competitiveness of Different Firms

Under the Administration's proposal, the health care costs of firms that compete directly with foreign firms (the "tradable goods sector") would probably decline. Those firms are much more likely than firms outside that sector to offer health benefits now, and they offer relatively generous benefits.[30] Nevertheless, this reduction in costs would not have much effect on the trade balance.

Although prices might fall, the dollar would rise enough to prevent the change in prices from significantly altering the trade balance. Much of the reduction in health spending would be passed on to workers in the form of higher cash wages. Some firms might pass a portion of their health cost savings through to their prices, depending on the market conditions they face. Thus, the prices of tradable goods could fall on average. But these price declines would probably lead to a strengthening of the value of the dollar relative to foreign currencies. A higher dollar would offset the lower costs in industries dealing with tradable goods, keeping the average price of U.S. goods to foreigners about the same.[31] One result would be to share the lower cost of producing tradable goods with the whole U.S. economy by reducing the cost of imported goods.

29. R. Glenn Hubbard, Jonathan Skinner, and Stephen Zeldes, "The Importance of Precautionary Motives in Explaining Individual and Aggregate Savings," Working Paper 4516 (National Bureau of Economic Research, Cambridge, Mass., November 1993); Martha Starr-McCluer, "Health Insurance and Precautionary Saving" (paper presented at the 1994 annual meeting of the American Economic Association, Boston, Mass., January 1994).

30. See Lewin-VHI, "The Impact of the Health Security Act on Firms Competing in International Markets" (paper presented to the Competitiveness Policy Council, Washington, D.C., December 10, 1993).

31. Henry Aaron and Barry Bosworth, "Health Care Financing and International Competitiveness" (paper presented to the Competitiveness Policy Council, Washington, D.C., December 10, 1993).

As discussed earlier, the Administration's proposal would redistribute insurance costs among different firms and industries, which could alter the prices of their goods and services. These price changes, in turn, could affect the international competitiveness of some companies, although firms whose costs decline by the average for the tradable-goods sector would see no change. For these firms, the reduction of their health costs would be exactly offset by the appreciation of the dollar.

But the international competitiveness of companies with larger-than-average cost reductions would improve. Although the dollar would appreciate, the insurance costs at these companies would fall even more. Firms that have smaller than average reductions--or cost increases--would become less competitive, however.

Conclusion

CBO estimates that the Administration's proposal could cause the number of people working to decline by about one-quarter of a percent to 1 percent, though most of these people would retire or turn to other activities outside the labor market. Unemployment would increase only slightly among minimum-wage workers. A decline in the labor force of that magnitude would reduce the potential market output of the economy by somewhat less, perhaps from 0.2 percent to 0.7 percent. In addition, the proposal would probably cause low-wage workers to move from firms where they would qualify for little or no subsidy to firms where they would attract greater subsidies. Such churning could impose noticeable, though unquantifiable, costs on the economy.

The proposal might also bring into the measured labor force, and measured GDP, some people who are now giving care to their disabled relatives. This would largely be a statistical change and would not significantly alter levels of economic activity.

These predictable changes in the labor force, though important, are in any case small relative to the normal growth and variation in the economy. CBO projects, for example, that the labor force will increase by some 13 percent in the next 10 years, and the predictable effects of the Administration's proposal are well within the range of uncertainty of that estimate. Further, the lower market output of the economy somewhat overstates the economic losses the proposal would cause. Those who left the labor force would engage in other activities--looking after children or enjoying leisure--that have value but are not captured in GDP.